Kentucky Law Journal

Volume 20 | Issue 2 Article 3

1932

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THE REGULATION OF PUBLIC UTILITIES, OTHER THAN RAILROADS, BY STATE ADMINISTRATIVE COMMISSIONS

The establishment, by the various states, of public service commissions grew out of a chaos of public utility regulation that was too deep-rooted to be eradicated by any policy which stopped short of thorough-going administrative control. Experience had demonstrated that competition could not be trusted to solve the problem of public utility rates; that regulation by direct action of the legislature was arbitrary and inadequate; that municipalities were not generally equipped to safeguard either the rate payers or the corporation; and that local franchise contracts were unjustly discriminatory. Thus, the states began to take upon themselves, thru state commissions, the obligation of protecting both the utility companies and the consumers.

The first commissions, established from 1844 to 1870, had a very limited jurisdiction with no control over rates, but merely the power to oversee railroad construction and operation. From 1860 to 1890 the Granger laws in the various states fixed maximum rates for freight and passenger service; from 1890 to 1902 the jurisdiction of the railroad commissions was extended to include certain technical matters and an increased power over railroad rates, providing a somewhat broader control in place of the arbitrary maximum standards fixed by the Granger laws. From 1902 to 1907 the tendency became manifest to extend the jurisdiction of the state commissions to utilities other than railroads. Since 1907 the authority and jurisdiction of the state commissions has been gradually extended to cover railroads and other public utilities. At the present time there are public service commissions in each of the forty-eight states, with the exception of Delaware, and in the District of Columbia. The spread of regulation by state commissions was rapid because it was based on scientific principles, and for the reason that, in practice, it resulted in the establishment of uniform accounting, reduction of rates, elimination of unjust discrimination, and the establishment of proper standards of service. In short, the commission system was accepted as the best agency for administering a general regulatory statute.

The modern period of state regulation may be said to have begun in 1907. In that year Wisconsin extended the jurisdiction of its commission to water, light, power, telephone, and telegraph companies; in New York the power to regulate was extended to cover gas and electric companies; and the jurisdiction of the Georgia commission was enlarged to include telephone, telegraph, gas, and electric companies. Coupled with the early records of the first commissions, the argument in favor of centralizing the public control of utilities in an administrative state commission was so compelling that the example was rapidly followed in other states, thru the creation of new state bodies, or the enlargement of the powers of the existing railroad commissions. Thus, commission regulation gradually superseded the troublesome method of direct negotiation between municipalities and local utilities, or the more laborious machinery of state legislative action in each specific case, and at the same time provided an agency clothed with power to regulate and supervise those utilities whose natural expansion resulted in their operating in more than one local jurisdiction. So, the present public service commissions were established because of the total or partial failure of the older forms of regulation, and this agency was deemed the best means for intelligent, prompt, and effective control of companies engaged in rendering a public service.

Aside from the aforestated reasons for the establishment of utility commissions there are others that have arisen from the expansion of utility companies and the many technical questions that are the outgrowth of such expansion and regulation. Many municipal public utilities are becoming interurban in their scope and are no longer local to the particular municipality whose jurisdiction accordingly is not sufficiently comprehensive to provide the necessary regulation and control. Each municipal corporation is necessarily limited to its own territory so that the only method by which to secure uniform regulation would be at the hands of a state public utility commission. Likewise utility commission being created to perform the important function of supervising and regulating the business of public service corporations it is necessary that the personnel of such a commission be composed of a trained body of experts who are unbiased, and who may dispose of all questions in the exercise of their trained and best judgments.

One of the most distinguishing characteristics of the general laws, which provide for the establishment of commissions, is that they view the regulation of utilities as one upon which continuous attention must be bestowed. Instead of periodic adjustments of rates, by means of special contracts or legislative acts, the present laws set up conditions which are to be continuously operative. Also instead of prescribing a specific rate for each public utility, previously the case, the statute merely lays down a general standard. This does not mean that specific rates and service regulations are not fixed; it merely means that they are not fixed by the statute, but are instead promulgated by administrative order of the commissions. The new system adopted the common law rule of reasonableness and declared it to be the legislative standard. The central problem with which these legislative standards deal has two aspects which generally are the basis of every utility act: (1) the furnishing of reasonably adequate service and facilities; (2) the collection of a charge, for every service rendered, which is reasonable and just.

It is the purpose of this paper to discuss, in general terms, the regulation of public utilities, other than railroads, by state administrative commissions, and the benefits that accompany such a form of regulation. There have been several phases of regulation, relating to public service corporations, that have been outstanding in the regulation of public utilities, and which will be discussed briefly in their respective order.

The development of the public regulation of securities has been the outstanding event in the recent history of public utility finance. The peculiarly American vice of looking for immediate returns and large profits by unloading securities upon the public was in marked evidence in the promotion of utility enterprises prior to state regulation. One of the chief aims of security regulation, from the popular standpoint, was to protect consumers by putting an end to overcapitalization and stock watering. Another purpose of such regulation was to preserve public utility credit, for the uncontrolled issue of public utility securities reacted both upon the credit and the service of the corporation. When such securities are issued to an inflated amount, one of two things must happen: either dividends must be paid at the expense of the proper maintenance of the utility facilities and as a result interfere with the necessary maintenance and depreci-

ation reserves, or the corporation must fail to pay any adequate return upon the securities so issued, which would destroy its credit. The deplorable financial condition of many utility companies emphasized the necessity for effective supervision and regulation over securities. Massachusetts merits recognition as the first state to seriously undertake the task of publicly controlling capitalization.

There are two leading views as to the proper method of regulating public utility security issues. One is that there should be absolute governmental control. Absolute control means the issuance of securities only upon the authorization of the commission based upon a statement of the amount and character of the issue desired, and its purpose together with a full report of the assets and liabilities of the company. Under this plan the commission sets a date for a hearing and investigates the application, and, if the issue is authorized, fixes the amount of the issue, the price for which it is to be sold, the purpose of the sale, the conditions under which they are to be issued, and makes any other requirements that are deemed essential. Modified governmental control is merely a publicity policy. The utility is required to furnish the commission with a detailed statement of the amount of the issue and the purpose for which the proceeds are to be used. This must be followed later by an accounting and a full statement to the stockholders.

Absolute control of the securities, by the commission, is the more favored policy. However it has been declared that the control of public utility securities was not designed to make the commissions the financial managers of the corporation, or to empower them to substitute their judgment for that of the board of directors or stockholders of the corporation as to the wisdom of a transaction; it was designed to make the commissions the guardians of the public by enabling them to prevent the issue of stocks and bonds and for other than necessary purposes.[1] It may be said that where a public service commission has the power to hear and determine the facts in relation to a proposed issue of securities, the action of the commission is compulsory if

[1] *People, ex rel. Delaware and H. Co.*, v. *Stevens*, 197 N. Y. 1, 90 N. E. 60; *Kansas City, Etc.*, v. *Bristow*, 101 Kan. 557, 167 Pac. 1138, P.U.R. 1918A; Re *Peoples Telephone Co.* (Neb.), P.U.R. 1915D, 160; Re *Farmers, Etc., Telephone Co.*, P.U.R. 1915B, 55; *Springfield Gas and Elec. Co. case*, 291 Ill. 209, 125 N. E. 891.

it finds the existence of facts showing the necessity for the issuance of such securities.[2]

The constitutional power of a state to delegate to commissions the determinations of the facts upon which public service commissions may be permitted to issue securities, with authority to approve or deny an application for such an issuance, dependent upon the commission findings as to whether the purpose or other conditions are such as are prescribed by law, is well settled.[3]

At the present time there are twenty-three state commissions who are empowered to regulate, in some manner, the issuance of securities by electric and gas companies, and the capitalization of them;[4] there are two additional states who have limited authority in the matter.[5] However, these laws regulating the issuance of securities of public utilities are divergent in many respects and it is practically impossible to interpret any uniform law of supervision due to the existing disparity now employed by the various commissions. Under subsection D of section 883e-3, Carroll's Kentucky Statutes, 1930 Edition, the Kentucky Securities Law is not operative, provided, the public service corporation "is subject to regulation or supervision as to its rates and charges or as to the issue of its own securities and those guaranteed by it by a public commission, board or officer of the government of the United States, or of any state, territory, or insular possession thereof, or of any municipality located therein, or of the District of Columbia, or of the Dominion of Canada, or any province thereof; . . ." Also, "Securities appearing in any list of securities dealt in on the New York Stock Exchange or any other recognized and responsible stock exchange which has been previously approved by the commissioner and which securities have been so listed pursuant to official authorization by such exchange . . . ; provided,

[2] *Fall River Gas Co.* v. *Board of Light Com.*, 214 Mass. 529; *State* v. *Great Northern R. Co.*, 100 Minn. 445, 111 N. W. 289; *Public Service Com.* v. *State*, 184 Ind. 273, 11 N. E. 10; *Kansas City* v. *Bristow, supra; Public Service Com.* v. *Indianapolis*, 193 Ind. 37, 137 N. E. 705; *Ala. Public Service Com.* v. *Mobile Gas Co.* (Ala.), 104 So. 538, 41 A. L. R. 872, and note.

[3] *Ala. Public Service Com.* v. *Mobile Gas Co., supra.*

[4] Alabama, Arizona, Arkansas, California, District of Columbia, Georgia, Illinois, Indiana, Kansas, Maine, Maryland, Massachusetts, Michigan, Missouri, Nebraska, New Hampshire, New York, New Jersey, North Dakota, Ohio, Tennessee, Vermont, and Wisconsin.

[5] Pennsylvania and Virginia.

the commissioner may at any time for cause withdraw the exemption allowed by this section from any security dealt in on any stock exchange herein mentioned or referred to." The last exemption named is provided by section 883e-3, subsection F, of Carroll's Kentucky Statutes, 1930 Edition. It is a prevalent belief of patrons of public utilities that the books of these companies may be juggled, so to speak, so as to conceal real profits and deceive the public as to the actual financial status and needs of the utilities. One of the great services that the commissions have rendered to the patrons of the utilities, as well as to the companies, has been the establishment of uniform accounting systems on a scientific basis, designed to show all of the facts necessary for the patrons and companies to know about the business.

The modern commission statutes give the commissions a discretionary power to regulate accounts and to prescribe accounting practices, as well as authority to enter on the premises of the utilities for the purpose of inspecting the companies' books and records. The importance of adequate and uniform accounting regulations may be easily recognized. Such regulation gives needed publicity of the financial transactions and operations of the company. It gives the investor, for the first time, reliable information in relation to the current affairs of the company, and furnishes the public and the commission with data needed to fairly judge the public relations of the utility.

The prime requisite of a proper accounting system is that it shall furnish the necessary facts for a correct analysis of the business. The primary purpose is to set forth the sources, utilization, and disposition of pecuniary values. There must be neither an inflation of the capital account, nor the creation of secret reserves. The fixing of reasonable rates is one of the principal functions of a public service commission. The reasonableness of rates is dependent upon the reasonableness of the return they produce. In determining the rate one of the paramount factors to be observed is the actual investment. By actual investment is meant the sacrifice or investment of the owners of the property, and not an investment of money derived from the rate payers. Therefore, if the books of the company are to furnish reliable information, they must be kept in an

accurate fashion. Additions and improvements must not be charged to operating expenses, nor should the cost of replacements be added to the capital account. Thus, to correctly determine the investment, accuracy of accounting is necessary.

After the reasonableness of the rate is determined it is necessary to ascertain what portion of the return is to be obtained from the various classes of consumers, and this can be learned only after a careful analysis of the cost of each class of service. It is desirable that each class should produce its fair proportion of the return in order that there be no discrimination. Regulation of accounting is therefore vital to the determination not only of the reasonableness of the rate as a whole, but as to the fairness of charges for different branches and classes of service.

The uniformity required is also a valuable feature of commission regulation of accounts, since it furnishes a basis of comparison from which the relative efficiency of a corporation may be determined. If the costs of a particular utility are running higher than the average costs of other utilities similarly situated, the reason for this can be inquired into. Another advantage of such regulation, once its purpose and scope is understood, will be its tendency to promote a better relationship and an extended degree of confidence between the utility and the public. Also accounting systems may be used, aside from regulation, to serve as a basis for budgetary control, and for the administration of tax laws.

If a state commission is to successfully perform its duties in prescribing reasonable rates, preventing unjust discrimination and insuring financial stability of the utility, it must be informed of the business of the operating company by a system of accounting which will not permit the possible concealment of forbidden practices in accounts. The object of requiring such accounts to be kept in a uniform way and open to the inspection of the commission, is to enable it to be informed of the business methods of the corporation, that it may properly regulate such matters as are pertinent to its jurisdiction.[6]

Laws have been enacted in thirty-four states authorizing the commissions to regulate the accounting practices of pri-

[6] *Kansas City Southern R. Co.* v. *U. S.*, 231 U. S. 423, 58 L. Ed. 296; *Interstate Commerce Commission* v. *Goodrich Transit Co.*, 244 U. S. 194.

vately owned electric and gas companies.[7] The statutes of thirty-one states require electric and gas companies to make general reports, and, in such cases as the commission may deem necessary, special reports. The statutes in twenty-nine of the thirty-four states are practically uniform in that the state commissions are required to conform to the classification of accounts prescribed in the "Uniform Classification of Accounts" adopted by the National Association of Railroad and Utility Commissioners. Under section 201e, 15, Carroll's Kentucky Statutes, 1930 Edition, the Railroad Commission requires telephone, telegraph, and natural gas companies to submit a "full and true statement" of the affairs of the company on or before the first day of September of each year.

Under the common law those engaged in public callings were required to furnish reasonably adequate service and facilities. Statutory regulations have superseded the common law and taken over that legal standard; also, regulatory provisions relating to specific matters of service have been enacted. Administrative commissions are charged with enforcing specific legislative requirements, and are given a discretion only in regard to the application of the general standard. The general and special provisions of these statutes, relating to public utility service, gives the commission complete power over the subject. Service and rates are very closely related. Commissions have the power to require adequate service only in case of a proper return; it cannot, under the guise of regulation, require a utility to expend large sums of money for the extension of its service into a new territory when the necessary result would be for the corporation to use its property for public convenience without just compensation.[8] This is plainly a sound view of the interrelation of service and rate questions. The provisions of the statutes giving the commissions such extensive powers over public utility service must be harmonized with those providing for a reasonable return. The statutes cannot, or should not, be applied in the

[7] Alabama, Arizona, California, Colorado, Connecticut, District of Columbia, Idaho, Indiana, Illinois, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nevada, New Hampshire, New York, North Dakota, Ohio, Oregon, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming, Georgia.

[8] *Sapulpa* v. *Sapulpa Electric R. Co.*, P.U.R. 1918D, 529; *People of N. Y., Etc.*, v. *Public Service Commission*, 269 U. S. 244, 70 L. Ed. 255; *Norfolk and W. R. Co.* v. *Pub. Serv. Com.*, 265 U. S. 70, 68 L. Ed. 905.

absence of such a return. However, when the return is sufficient the power to compel adequate service is undoubted.[9] These statutes are not intended to hamper the utilities, and, aside from the general standards, the corporations are free to make their own rules and regulations subject to the power of the commission to change or modify them.[10] As regards extensions, the power of the commission in proper cases is unquestioned. In many cases such power of regulation is specifically conferred by statute.[11] But, even in the absence of specific mention of extensions in the statutes, it seems that such authority is conferred by the general provisions of the law which gives to the commissions power to require adequate service and rates. Altho the commissions have considerable latitude over utility extensions of service, their authority over the subject is not arbitrary. Only such extensions may be required as are reasonably necessary. Most of the controversies which have arisen have been over the reasonableness of the demand for the service under the conditions presented in the various cases.[12] The courts have no authority to substitute their judgment for that of the commission as to what is reasonable in a given case, but are limited to determining whether the action complained of was arbitrary or capricious, and therefore unlawful.[13]

The enactments in the various states, giving the commissions power to regulate and define service standards to be observed by the utilities, are notably uniform. All but five states have the authority to control electric and gas services,[14] altho the control in three states does not extend to both types of service.[15]

There is no duty imposed on the various state regulatory commissions more important than that of fixing reasonable

[9] *Pub. Serv. Com.* v. *Pudget Sound Traction, Etc., R. Co.* (Wash.), P.U.R. 1915B, 799; *Pub. Serv. Com.* v. *Nevada Northern R. Co.* (Nevada), P.U.R. 1919F, 334.

[10] *B. & O. R. Co.* v. *Pub. Serv. Com.* (W. Va.), P.U.R. 1918 B, 608, 94 S. E. 545.

[11] *Cabrillo Club* v. *Atchison, Etc., R. Co.* (Cal.), P.U.R. 1916A, 102; *Scranton* v. *Scranton R. Co.* (Pa.), P.U.R. 1915C, 890.

[12] *Churchill* v. *Winthrop & W. Light & P. Co.* (Me.), P.U.R. 1916F, 752; Re *Pleasantville Gas Co.* (N. J.), P.U.R. 1920 E, 404; Re *N. Y. and Q. Gas Co.* (N. Y.), P.U.R. 1915B, 821; *Scottdale* v. *Citizens Water Co.* (Pa.), P.U.R. 1920D, 292; Re New Richmond (Wis.), P.U.R. 1915B, 243.

[13] *People ex rel.* v. *McCall*, 245 U. S. 345, 62 L. Ed. 337; *Brooklyn Heights R. Co.* v. *Straus*, 245 Fed. 132.

[14] Florida, Iowa, Minnesota, Mississippi, and South Dakota have no control over service.

[15] Kentucky and Texas have control over the service of natural gas. Nebraska may prescribe service standards for electricity.

charges. The regulation of public utilities received its orientation from the fact that rate problems were the first to engage the attention of the public authorities. Every phase of utility regulation is, in some manner, closely related to the rate charge. The power to regulate rates inherently rests in the state and is strictly a legislative function. It has hereinbefore been stated that the legislature has neither the time nor the facilities to investigate matters pertaining to rate making, and the establishment of commissions was considered the most appropriate and beneficial method by which particular rates may be prescribed and maintained. Since the famous case of *Munn* v. *Illinois* was decided on March 1, 1877,[15a] wherein it was held that private property devoted to a public use is subject to public regulation, it has since been continuously recognized that rate making is a legislative function to be exercised by the legislature or its agent.[16]

Practically every regulatory statute provides that the charge for service shall be just and reasonable and no higher than allowed by law or order of the commission, and prohibits every unlawful or unreasonable charge which is in excess of that allowed by law or order of the commission. The administrative body may investigate the reasonableness of rates either upon its own motion or upon complaint, and if the rates so investigated are found to be unjust, new rates may be prescribed.[17] The fact that a commission is given the power to fix just and reasonable rates makes it very plain that the commission has the authority to increase, as well as decrease, rates.[18]

From a broad viewpoint the power given to the commission was not delegated for the purpose of protecting any one person or another, but primarily to secure justice. In fixing the rates the commission, as the agent of the state, acts in a legislative capacity; in determining the reasonableness of rates it is a fact finding body, and to that extent quasi-judicial in determining the issue from the evidence. It may be said that the commission should see: First, that the patrons get what they pay for;

[15a] 94 U. S. 113, 24 L. Ed. 77.

[16] *Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, 53 L. Ed. 371; *Newton* v. *Consolidated Gas Co.*, 258 U. S. 165, 66 L. Ed. 538; *Bluefield Water Works, Etc., Co.* v. *Pub. Serv. Com.*, 262 U. S. 679, 67 L. Ed. 1176.

[17] Re Bronx Gas and Elec. Co., P.U.R. 1918D, 300, 320.

[18] *People. Etc., D. R. Co.* v. *Pub. Serv. Com.*, 156 N. Y. S. 1065 P.U.R. 1916E, 243; affirmed in 218 N. Y. 643, 112 N. E. 1071.

Second, that the public pays for what it gets; and Third, that the policy pursued by the regulatory body be such as to assure at all times the improvement and development of such utility enterprises as will meet the public need for public utility service.[19]

It is to be remembered that the rate making power is based on the police power of the state.[20] The use of the police power by the legislature or its legally delegated agency, the regulatory body, is limited by the Constitution of the United States and the constitution of the state in which it functions. Thus, a regulatory rate order is of the same effect as a legislative enactment and is subject to the same limitations. All regulatory rate orders which transcend the limitations of either the state or Federal constitutions are void. Applying the guaranties afforded by the Federal Constitution, the United States Supreme Court has declared a number of limitations on the power of regulatory bodies, in rate-making, which must be respected. The fourteenth amendment to the Federal Constitution, thru the "due process" and "equal protection of the laws" clauses, provides the most important limitations of state legislative power.[21]

When the laws establishing the commissions were first enacted, there were certain maximum rates prescribed by statute which were not expressly repealed; there were also many franchises and other contracts in existence. Thus, the question soon arose as to how far the commission's authority extended in the face of these general rate laws and franchise contracts. As regards the maximum rate laws, there are two principle questions: First, do the maximum rate laws prohibit the commission from reducing rates below the level fixed in the acts? There would seem to be little room for doubt as to the commission's authority to do this, but the question has been raised. The decisions seem to be uniform in upholding the commission's

[19] Re Bronx Gas and Electric Co., supra.

[20] *Union Dry Goods Co.* v. *Ga. Pub. Serv. Com.*, 248 U. S. 372, 63 L. Ed. 309.

[21] Minnesota Rate Cases, 230 U. S. 352, 57 L. Ed. 1511; Missouri, ex rel. Telephone Co., Case, 262 U. S. 276, 67 L. Ed. 891; Indianapolis Water Co. Case, 272 U. S. 400, 71 L. Ed. 316; Ohio Utilities Co. Case, 267 U. S. 359, 69 L. Ed. 656; N. Y. Telephone Co. Case, 271 U. S. 23, 70 L. Ed. 808; *Wichita R. & L. Co.* v. *Pub. Serv. Com.*, 260 U. S. 48, 67 L. Ed. 124.

power to reduce rates regardless of the maximum rate laws.[22] The second question, and the more important of the two, is whether or not the enactment of commission laws repeal by implication the maximum rate statutes, so that the commission may have a free hand in prescribing reasonable rates. There is a seeming conflict of authority on this issue which may be partly reconciled by the difference in the various state statutes. The weight of authority seems to be of the view that when the commission is established, the maximum rate laws are impliedly repealed.[23] There is considerable authority, however, to the effect that the commissions are bound by the maximum rate statutes.[24]

The greatest controversy in recent years has been over those contracts in which rates were fixed by franchise and, upon acceptance by the utility, became binding agreements between the municipality and the public service corporation. It may be stated as axiomatic that the police power is inherent in the sovereign; that the regulation of utility rates comes from within that power; and that its exercise may be by the state or its lawfully delegated agencies. A state may authorize a municipality by agreement to establish public utility service rates and thereby suspend for a term of years, not grossly excessive, the exertion of governmental action to fix compensation to be paid for the services rendered by public service corporations.[25] The law is also uniform in sustaining the view that the Courts may

[22] *People, ex rel. D. & H. Co.*, v. *Pub. Serv. Com.*, 125 N. Y. S. 1000; Re Rochester (N. Y.), P.U.R. 1915A, 1095; *State Pub. Util. Com.* v. *Mitchell, Etc., R. Co.*, 275 Ill. 555, 114 N. E. 325, P.U.R. 1917B, 1046.

[23] Re Portland R. Light and P. Co. (Ore.), P.U.R. 1918A, 751; *Oklahoma City* v. *Corporation Commission* (Okla.), P.U.R. 1921C, 801; *State, ex rel. Rhodes*, v. *Pub. Serv. Com.* (Mo.), P.U.R. 1917E, 315; *Robertson* v. *Wilmington and P. T. Co.*, P.U.R. 1919B, 129, 139; *State, ex rel. Pub. Serv. Com.*, v. *B. & O. R. Co.*, 76 W. Va. 399; Re Huntington Railroad Co. (N. Y.), P.U.R. 1918A, 249; *Board of Survey of Arlington* v. *Bay State R. Co.*, 224 Mass. 463, 113 N. E. 273; *State, ex rel.* v. *Pub. Serv. Com.*, 259 Mo. 704, 168 S. W. 1156.

[24] Re Northern Pac. R. Co. (Mont.), P.U.R. 1920F, 11, 15; Re W. Passenger Ass. (Mont.), P.U.R. 1920F, 715; Re Railroads, (Neb.), P.U.R. 1920F, 17; *State Pub. Util. Com.* v. *Mitchell, Etc., R. Co.*, P.U.R. 1917B, 1046, supra.

[25] *Columbus R. and P. Co.* v. *Columbus*, 249 U. S. 399, 63 L. Ed. 699, P.U.R. 1919D, 239; *Ga. R. and P. Co.* v. *Decatur*, 262 U. S. 432, 67 L. Ed. 1065; *Opelika* v. *Opelika Sewer Co.*, 265 U. S. 215, 68 L. Ed. 685; *St. Cloud Pub. Serv. Com.* v. *St. Cloud*, 265 U. S. 352, 68 L. Ed. 1050; *Southern U. Co.* v. *Palatka*, 268 U. S. 232, 69 L. Ed. 931; *Interborough Rapid Transit Co.* v. *Gilchrist*, 279 U. S. 159, 73 L. Ed. 652; *Ky. Power and Light Co.* v. *Maysville* (Ky.), 36 Fed. (2nd) 816.

not relieve a public utility, bound by a franchise to render service for fixed amounts, from the obligation to serve at the agreed rates however inadequate they may prove to be.[26] In the absence of an inviolable contract, the power of the state in its sovereign capacity to regulate the rates of public service corporations upon the application of the utility involved, thru its commission or otherwise, to increase the rates fixed by contract, in whatever form such contract has been entered into franchise or otherwise, has been settled beyond dispute. This rule is predicated on the ground that a contract of this kind imposes no restriction on the sovereign power of the state to fix just and reasonable rates as changing conditions may make desirable. It is a contract subject to the states sovereign power over rates, and when the state, thru its public utility commission, exercises its sovereign power over such charges the contract rights of the parties must yield. It is seemingly an attribute of sovereignty which cannot be contracted away, and in contemplation of which all contracts or agreements are made. It has, also, been legally settled that the constitutional prohibitions against the impairment of contract obligations which protect private contracts concerning property rights do not go to contracts touching governmental functions, for no obligation of contract can be extended to defeat legitimate governmental power.[27]

The amount of the rates to be charged by utility companies, other than railroads, in the state of Kentucky, with few exceptions is fixed altogether by franchise contracts between the municipal corporations and the public service corporations. A part of section 201, E1, Carroll's Kentucky Statutes, 1930 Edition, relating to the duties of the Railroad Commission, expressly states:

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[26] *Denney* v. *Pacific Tel. and Tel. Co.*, 276 U. S. 97, 72 L. Ed. 483; *Henderson Water Co.* v. *Corporation Committee*, 269 U. S. 278, 70 L. Ed. 273; *R. Com. of Cal.* v. *Los Angeles Ry. Com.*, 280 U. S. 145, 74 L. Ed. 234; *Southern Iowa Electric Co.* v. *Chariton*, 255 U. S. 539, 65 L. Ed. 764; *San Antonio* v. *San Antonio Pub. Serv. Com.*, 255 U. S. 547; 65 L. Ed. 777; *Columbus R. P. and L. Co.* v. *Columbus*, 249 U. S. 349, 63 L. Ed. 669; *Paducah* v. *Paducah Railway Co.*, 261 U. S. 267, 67 L. Ed. 647.

[27] *Leiper* v. *Baltimore, Etc., R. Co.*, 262 Pa. 328: 105 Atl. 551, P.U.R. 1919C, 397; *State, ex rel. Billings*, v. *Billings Gas Co.*, 55 Mont. 102, 173 Pac. 799, P.U.R. 1918F, 768; *Ansonia* v. *Ansonia Water Co.*, 101 Conn. 151, 125 Atl. 474; *People, ex rel.*, v. *Pub. Serv. Com.*, 225 N. Y. 216: 121 N. E. 777: P.U.R. 1919C, 374; *Richmond* v. *Virginia R. and P. Co.*, 141 Va. 69, 126 S. E. 353; also see authorities supra.

"The provisions of this act shall not embrace the operation of telephone companies within any city where the rates charged for the transmission of messages and any other service may be regulated by local authority, or the operation of natural gas companies in any city where the rates are now or may be regulated by local authority; . . . nor shall the provisions of this act apply to any telephone or gas company operating in any municipality under a franchise or contract fixing or regulating the rates which said company may charge, or the terms and conditions under which said company is operating."

In an unbroken line of decisions the Kentucky Court of Appeals has held that no franchise to conduct business and occupy the streets and public ways of a municipality of this Commonwealth can be acquired in any other way than by a strict compliance with sections 163 and 164 of the Kentucky Constitution. There must be a public advertisement of bids; the bids must be received publicly; the franchise must be awarded to the highest and best bidder, and cannot be granted for a period in excess of 20 years, and upon the expiration of the life of the franchise the owner thereof has no longer the right to occupy and use the public ways of the municipality, and can acquire no such right, nor can the city grant any such right, except that a new sale is affected under the provisions of sections 163 and 164 of the Constitution.[28]

Section 164 of said Constitution prescribes certain conditions upon which a municipality is authorized to grant a franchise, or privilege, which is limited to a term not exceeding twenty years. Section 163 requires the municipality's consent as a prerequisite to the use or the obstruction of the public streets or grounds by certain designated public utilities, mainly gas, telephone, telegraph, water and electric light companies. It will be observed that in vesting a municipal corporation with the sole power to grant a public utility franchise, within its limits, there is no restriction of terms except duration of time. It has been held by the Kentucky Court of Appeals that these provisions are self-operative and confer upon the municipalities authority to grant franchises to those specified utilities over

[28] *Rural Home Tel. Co.* v. *Independent Tel. Co.*, 128 Ky. 209, 107 S. W. 787; *Princeton* v. *Princeton E. Light and P. Co.*, 166 Ky. 730; 179 S. W. 1074; *City of Somerset* v. *Smith*, 105 Ky. 678, 49 S. W. 456; *Peoples Elec. Light & P. Co.* v. *Capitol Gas Co.*, 116 Ky. 77, 75 S. W. 280; *Hamilton* v. *Bastin Bros.*, 188 Ky. 764, 224 S. W. 430; *East Tenn. Tel. Co.* v. *Anderson County*, 115 Ky. 488, 74 S. W. 218; *Norris* v. *Ky. State Tel. Co.*, 235 Ky. 234, 30 S. W. (2d) 960.

which they are given supervision.[29] The constitutional delegation of such power to the municipal corporations forbids the Commonwealth from regulating those utilities, operating in municipalities, through a State regulatory body functioning pursuant to a State public service law. Thus, a public service corporation may transact business in this Commonwealth only by complying with sections 163 and 164 of the Constitution, and which subjects them to control and supervision of the municipal authorities within whose limits their business is carried on.

The question has arisen as to whether or not the Railroad Commission may compel a utility company to continue service on a reasonable basis after the franchise has expired. Section 201e-23, Carroll's Kentucky Statutes, 1930 Edition, prescribes that if a public utility, after the expiration of its franchise in any city, continues in its business without obtaining a new franchise, it shall be subject to the jurisdiction and authority of the Railroad Commission, and shall not withdraw its service without first obtaining permission of the Commission so long as it remains in business in this Commonwealth or any part thereof. Under this section of the statute it has been argued that a public utility, over which the Railroad Commission has control, may be compelled to furnish service after the franchise has expired. However, that section has been construed to mean that any public service corporation which has voluntarily continued its service after the expiration of the franchise to be under the jurisdiction of the Railroad Commission.[30] On the other hand it has been held that all obligations on the part of the utility company to furnish service terminates upon the expiration of the franchise. This ruling may be distinguished from that in the *United Fuel case, supra,* for in that case the United Fuel Company voluntarily continued to serve the municipality for a period of five years after the expiration of the franchise, and it is true that when a utility voluntarily renders service after the franchise has expired it is brought within section 201e-23, supra, and thus subjected to the jurisdiction of the Railroad Commission. The

[29] *Tri-State Ferry Co.* v. *Birney,* 235 Ky. 540, 31 S. W. (2nd) 932; *Russel* v. *Kentucky Utilities Co.,* 231 Ky. 311, 22 S. W. (2nd) 288; *Irvine Toll Bridge Co.* v. *Estill County,* 210 Ky. 170, 275 S. W. 634; also see: *Home Tel. and Tel. Co.* v. *Los Angeles,* 211 U. S. 265, 53 L. Ed. 176; and 6 R. C. L., page 168, section 168.

[30] *United Fuel Co.* v. *Railroad Com. of Ky.,* 278 U. S. 300, 73 L. Ed. 290.

rule that the Commission cannot require a utility to continue in operation arises when there is an involuntary continuation of service, as under mandatory orders of a court.[31]

A recent provision added to some of the statutory enactments covering the regulation of public utilities is the "indeterminate permit." This is nothing more than an unlimited franchise, which may be terminated by municipal purchase or by law for mis-user or non-user. Experience has shown that term franchises are unsatisfactory to the utilities, investors and consumers alike. Utility franchise contracts which are limited in years of existence should be amortized in such a manner as to return the money invested at the termination of the franchise, yet rates must not exceed the amount necessary to yield a proper return and such a rate is not sufficient to amortize the investment. Furthermore, the plant cannot be scrapped at the end of the franchise period; the public must still be served, and so there is really no economic reason for amortizing the investment. Also the grantees of franchises must trust in their ability to secure renewals at the end of the franchise period, and many times political manipulations, that attend local politics, stand in the way of such a renewal. The perpetual franchise is objectionable because it stands in the way of service improvements, and in case of abuse the public has no recourse. Likewise, the rates being fixed by contract there is no provision for flexible accommodation to changing economic conditions. The indeterminate franchise, or permit, strikes a middle course between the term franchise and the perpetual franchise.

The indeterminate permit offers a satisfactory alternative in that it recognizes the monopoly character of the business, removes the need for amortization funds, provides for flexible accommodation in rates and service to changes in economic conditions, gives the municipality an option to purchase at a fair price, and protects the exclusive nature of the grant by requiring potential competition to secure a certificate of necessity and convenience from the state regulatory commission. The real difference between the new grant and the old one is that under the indeterminate permit the monopolistic feature may be

[31] *Union Light, Heat, and Power Co.* v. *Railroad Com. of Ky.*, 17 Fed. (2nd) 143; *Union Light, Heat, and Power Co.* v. *City of Ft. Thomas*, 215 Ky. 384, 285 S. W. 228; *City of Ludlow* v. *Union Light, Heat, and Power Co.*, 231 Ky. 813, 22 S. W. (2nd) 909.

changed at any time by the commission, thru the issuance of a certificate of convenience and necessity. In addition to this, the utility under the new grant agrees that it will sell its property at any time, upon reasonable notice, to the municipality without the cumbersome condemnation procedure formerly necessary. Thus, it may be said: First, that the indeterminate permit recognizes the monopolistic character of public utilities and prohibits the competition of new enterprises unless public convenience and necessity, as determined by the administrative commission, requires another utility; and Second, the right to operate and occupy the public streets is indeterminate, subject to the right of the municipality to purchase at any time at a fair price to be fixed by the administrative commission.

At the present time there are only a few states which have specific enactments on indeterminate permits, but there is a tendency toward its wider use.[32] The national government has adopted the principle of the indeterminate permit and all public service corporations in the District of Columbia operate under franchises of that nature; all licenses issued to hydro-electric companies under the Federal Water Power Act of 1920 are based on its underlying principles.

State regulation of public service corporations by state regulatory commissions has become an established institution which is destined to develop in scope and importance during the next several decades. The development will invariably follow the present gradual increase in the number and extent of public utilities and the growing importance of their position in our economic and social structure. Uniformity of regulation will, it is believed, be reflected in decreased operating costs and improved service. Commission regulation no longer bears aspects of experiment or novelty. There is now little dispute as to the advantage of this type of regulation to the public and to industry. The more important questions now involved concern the extent and character of such regulation.

So far as the commissions are concerned the power of regulation is now generally accorded them. However, in many cases

[32] Wisconsin, Indiana, Illinois, Louisiana, and New York have adopted such provisions. Ohio and California have indeterminate permit laws which relate to street railways only. Also, see Uniform Public Utilities Act, approved by the American Bar Association, sections 21 to 26 inclusive.

such regulation is made ineffective by court decisions. If the commissions are to be held responsible for the economic development of public utilities, and for the protection of public interest in them, they must be free to adopt measures which, in their opinion, are calculated to bring results. These administrative standards should, of course, be subject to judicial review so that private property may not be confiscated, and the initiative of private management not be taken away. But, where the commission's action is not palpably confiscatory, the judiciary should not substitute its judgment for that of the commission as to what the administrative standards should be.

If the commissions are to work well, they must be more adequately financed. If they are to to retain and develop an effective personnel they must be able to bid for specialized talent with the public utilities, offering careers in the public service which will appeal to young men. The term of office of utility commissioners should be of sufficient tenure and the salaries of a sufficient amount to obtain the high type and thoroughly competent men whose decisions will receive the support to which they are entitled. The importance of giving administrative commissions an independent status, protected alike from the undue interference and influnece of public utility officials and politicians cannot be over-emphasized. Though their duties are now more important and the reliance of the public upon them is greater, the influences which pervert administrative agencies are also stronger. Both public officials and the public utilities should co-operate with, but not control, administrative commissions.

If the work of regulation is to be effectively done, it must be in the hands of the mandatory type. In the development of legislative policies the initiative should be taken by the commissions, for they are in closest touch with the problems. Criticisms, investigations, and experimentation should be encouraged. At the same time both the commissions and the utility corporations should be protected from fallacious, insincere political attacks. Nothing can be more suicidal than to have regulation settle down to a complacent routine which contents itself with the mere adjudication of differences.

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KENTUCKY LAW JOURNAL

Volume XX JANUARY, 1932 No. 2

Published four times a year by the College of Law, University of Kentucky. Issued in November, January, March and May.

Subscription Price $2.50 per year 65c per number

It is assumed that a continuation of the Journal is desired unless notice to the contrary is received upon expiration of a subscription.

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